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THE POSSIBILITY OF VARIATIONS IN TARIFF RATES TO SECURE PROPER STANDANDS OF WAGES AND HOURS

BY

James W. Irwin

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MEMORANDUM TO: SECTION HEADS December 30, 1935

SUBJECT: WORK MATERIALS NO. 21

THE POSSIBILITY OF VARIATIONS IN TARIFF RATES TO SECURE PROPER STANDARDS OF WAGES AND HOURS

This preliminary draft of THE POSSIBILITY OF VARIATIONS IN TARIFF RATES TO SECURE PROPER STANDARDS OF WAGES AND HOURS by James W. Irwin is made available for confidential use within the Division of Review because of its usefulness in connection with other studies.

It is a preliminary draft -- an exploration of the field as a basis for further work. Not all material in it has as yet been verified and checked, nor does it present a fully rounded treatment of the subject.

L. C. Marshall
Director, Division of Review

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THE POSSIBILITY OF VARIATIONS IN TARIFF RATES TO SECURE PROPER STANDARDS OF WAGES AND HOURS

Question

Pursuant to direction received recently, I submit the following discussion on the topic of possibility of the use of variations in tariff rates to secure and maintain adequate standards as to wages and hours of employees in industry.

The thought presents itself that the flexibility of rates might be based upon either of two lines of approach: First, upon whether the importer was maintaining proper wage and hour standards; second, upon whether the producing industry in America sought to be protected by the rates involved, was maintaining proper standards. The two could not both be used because of inevitable conflict where the importer of a foreign product maintained an acceptable scale of wages and hours, and the American producer of the competing product did not conform to such acceptable standards, - or vice versa. Probably the second line of approach above referred to is the one which would ordinarily occur to a person considering the utilization of tariff regulations for the purpose above set forth. It would be the more promising, because of the vastly greater number of those employed by manufacturers and producers as compared to those employed by importers. Therefore, it is from this point of view that the question will be considered.

Discussion

I

This report may be summarized as follows:

The plan of varying tariff rates according to the maintenance of, or failure to maintain, acceptable standards as to hours and wages of employees in the industry for the protection of which the tariff rates are fixed, from a standpoint of logic is peculiarly appropriate. Apparently, a constitutional law looking toward effectuation of such a plan could readily be framed. In fact, it might be said to be already in effect. But it seems to be clear that this plan, in spite of its legal possibility and logical fitness, is practically unsound. At the very most it could be used only as an auxiliary scheme. There are better approaches and this one has too many blocking obstacles.

II

The logical appropriateness of the plan is obvious.

Perhaps the most effective and the most vocally urged argument in favor of the protective tariff, has been that it is necessary to guard the alleged high living standards of the American Laborer against debasement resulting from competition between American goods and those which, without a tariff wall, would be dumped into this country at the low prices made possible through lower living standards of labor in the country of their origin.

Therefore, to the extent that any beneficiary industry is derelict in maintaining those favorable labor conditions which it is alleged justify the protective tariff, to that extent justice would seem to demand that the tariff be lowered.

III

There can be little question that legislation for such a variation in tariff rates is within the confines of the Constitution, and of the rules of its interpretation already laid down by the Supreme Court.

The Tariff Act of June 17, 1930 includes the following provision (46 Stat. 701, U.S.C.A., Title 19, § 1336-a):

> "In order to put into force and effect the policy of Congress by this chapter intended, the commission (1) upon request of the President, or (2) upon resolution of either or both Houses of Congress, or (3) upon its own motion, or (4) when in the judgment of the commission there is good and sufficient reason therefor, upon application of any interested party, shall investigate the difference in the costs of production of any domestic article and of any like or similar foreign article. In the course of the investigation the commission shall hold hearings and give reasonable public notice thereof, and shall afford reasonable opportunity for parties interested to be present, to produce evidence, and to be heard at such hearings. The commission is authorized to adopt such reasonable procedure and rules and regulations as it deems necessary to execute its functions under this section. The commission shall report to the President the results of the investigation and its findings with respect to such differences in costs of production. If the commission finds it shown by the investigation that the duties expressly fixed by statute do not equalize the differences in the costs of production of the domestic article and the like or similar foreign article when produced in the principal competing country, the commission shall specify in its report such increases or decreases in rates of duty expressly fixed by statute (including any necessary change in classification) as it finds shown by the investigation to be necessary to equalize such differences. In no case shall the total increase or decrease of such rates of duty exceed 50 per centum of the rates expressly fixed by statute."

Subsection (b) provides that under certain conditions the Commission may recommend a change of basis for tariff rates from the foreign market value or cost of the imported article to the American selling price of its domestic competitor.

Subsection (c) vested the final power of action as to raising or lowering of statutory tariff rates in the President.

> "The President shall by proclamation approve the rates of duty and changes in classification and in basis of value specified in any report of the commission under this section, if in his judgment such rates of duty and changes are shown by such investigation of the commission to be necessary to equalize such differences in costs of production."

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The foregoing constitute the so-called "flexible tariff provisions." They have been vigorously assailed, both on grounds of policy and on grounds of constitutionality. In 1926 a Committee investigation was ordered pursuant to Senate Resolution 162, 69th Congress. A majority of the Committee advised that the flexible provisions be repealed chiefly for the reason that the President was already overburdened with executive duties.

In several cases the constitutionality of these provisions has been before the Customs Court and the Court of Customs and Patent Appeals, where decision was sometimes by a divided court.

Doubt as to the constitutionality of this section of the statute was finally set to rest by the Supreme Court in the case of J. W. Hampton, Jr. & Company v. United States, 276 U.S. 394, 72 L. Ed. 624 (1928). This case challenged the action of the President in having made a 50 per cent increase in the duty on a certain chemical product. The constitutionality of the statute was questioned both on the ground that it made to the President an unauthorized delegation of legislative power, and on the ground that it involved an illegal levying of a tariff, which it was contended could be levied only for revenue purposes.

As a succinct answer to the first of these attacks, I quote the following from the opinion of the court at page 409 of 276 U.S. Reports:

> ". . . The same principle that permits Congress to exercise its rate making power in interstate commerce, by declaring the rule which shall prevail in the legislative fixing of rates, and enenables it to remit to a rate-making body created in accordance with its provisions the fixing of such rates, justifies a similar provision for the fixing of customs duties on imported merchandise. If Congress shall lay down by legislative act an intelligible principle to which the person or body authorized to fix such rates is directed to conform, such legislative action is not a forbidden delegation of legislative power. . . ."

The answer to the attack on the delegation of power to the President was extended in the case of Fox River Butter Co. v. United States, in which the Court of Customs and Tax Appeals sustained his right to vary classifications as well as rates. (2d C.C.P.A. - Cust. - 38) The decision was approved by the Supreme Court by refusal to grant a writ of certiorari (287 U.S. 628).

From the reply to the second proposition of the alleged perversion of the use of the taxing power, the following passage from the Hampton Case (276 U.S. 412) is quoted:

> ". . . Whatever we may think of the wisdom of a protective policy, we can not hold it unconstitutional.
>
> "So long as the motive of Congress and the effect of its legislative action are to secure revenue for the benefit of the general government, the existence of other motives in the selection of the subjects of taxes can not invalidate Congressional action. As we said in the Child Labor Tax Case, 259 U.S. 20, 38: 'Taxes are occasionally imposed in the discretion of the legislature on proper subjects with the primary motive of obtaining revenue from them, and with the incidental

> motive of discouraging them by making their continuance onerous. They do not lose their character as taxes because of the incidental motive.' And so here, the fact that Congress declares that one of its motives in fixing the rates of duty is so to fix them that they shall encourage the industries of this country in the competition with producers in other countries in the sale of goods in this country, can not invalidate a revenue act so framed. Section 315 and its provisions are within the power of Congress. The judgment of the Court of Customs Appeals is affirmed."

In view of the opinion of the court, as summarized in the last quotation, it can not be doubted that "flexible tariff rates" may legally be applied for the protection of standards of American labor.

Another case in which the "flexible tariff provisions" were sustained was Norwegian Nitrogen Products Co. v. United States, 288 U.S.294, 77 L. Ed. 796. The issues were not so broad as in the Hampton or the Fox River Cases, supra, being concerned primarily as to methods of procedure. But there is one pertinent paragraph which may be quoted:

> "No one has a legal right to the maintenance of an existing rate or duty. Neither the action of Congress in fixing a new tariff nor that of the President in exercising his delegated power, is subject to impeachment if the prescribed forms of legislation have been regularly observed."

It may be remarked that the "flexible tariff provisions" involved in the cases cited were those of the Tariff Act of 1922. However, the distinctions between them and the corresponding sections of the present act are essentially different in form, and could not possibly affect the reasoning of the court.

It may be further observed that although the first "flexible tariff provision" were those of the 1922 Act, nevertheless, they were merely an extension and development of well-established principles of law governing executive authority in relation to the tariff. The extent of this executive authority as already firmly established may be seen in the following passage from 23 R.C.L. 1008, which was published in 1919, three years prior to the first "flexible tariff provisions":

> "The President may be made the agent of Congress to determine the events of which the expressed will of Congress concerning duties should take effect and thereupon to proclaim such will. Thus, he may be authorized and instructed to suspend the free list as to countries which impose duties on products of the United States, whenever he deems such duties reciprocally unequal and unreasonable, provided Congress fixes beforehand the duties which will attach on such suspension."

The foregoing quotation from R.C.L. omits reference to the broadest authority delegated to the President in relation to tariff rates prior to the 1922 Act. This was the provision of the Act of 1909 which set up a system of maximum and minimum rates with permission to the President to adopt one set or the other.

IV.

Corollary to the problem of whether a system of tariff variations can be used to assure fair wage and hour practices, is the question of what legislation would be required if such a policy were to be pursued. Theoretically, the answer might be "none". The provisions of the Tariff Act of 1930 hereinbefore quoted, give the President the right to raise or lower tariff schedules to the extent of 50 per cent, if necessary to equalize costs of production abroad and here. Therefore, it would seem to be within his power to say that satisfactory labor conditions constitute an essential element of the American production cost, and that the tariff schedules shall be high enough to render such labor conditions feasible; and to make a correction of deficient standards of labor conditions in any industry a requirement to ward off a drastic tariff reduction.

But before there is an embarking on such an executive policy, the statute should be amended to make clearer a legislative policy to protect the interests of labor.

At present, it could be contended that only existing costs of productions can be compared in determining whether the change in tariff rates should be made. Assuming an American industry, where existing labor rates are inadequate. and production costs here and abroad are on a parity under present tariff standards, it might be contended no variation of customs schedules could be made to aid labor.

Again, the amended Act should avoid implied requirement that before there is any tariff reduction because of unfairness of an industry toward labor there must be a mathematical demonstration that increased labor costs would leave the American industry on absolute equality of cost with its foreign competitor. It may be true that American tariff rates are uniformly high enough to protect labor, but it might be a complex undertaking to establish this in a given instance.

The clarification as to legislative policy hereinbefore referred to, I think can be accomplished by the following legislative changes:

Where Section 1336 (a) (quoted at pages 3-4 of this memorandum) sets forth a duty of the Tariff Commission to "investigate the difference in the cost of production of any domestic article and of a like or similar foreign article", there should be inserted a provision similar to the following:

> "making due allowance in estimating the said domestic cost in the production of any domestic article, for maintaining a minimum wage and maximum hour scale for labor in the industry concerned consistent with reasonable standards of comfort, health and well-being of the employees in said industry."

At the conclusion of said Section 1336 (2) there should be added a paragraph substantially as follows:

> "It is further provided that the duty of investigation by the said Tariff Commission shall extend to investigation of the extent to which any industry whose domestic product is favored by a protective tariff, does not maintain a standard of wages and hours for labor as hereinbefore described, and the Commission shall report to the President what reduction in the tariff it believes would be just

on account of said failure to maintain wage and hour standards of labor; which reduction shall not be in excess of fifty per cent (50%) of the original statutory tariff rate, if any, as may have been made pursuant to order of the President."

Probably there should be an enactment (in a separate act however) granting exemption from anti-trust laws in favor of any agreement among members of an industry relating solely to maintaining fair wage and hour standards. The purpose of this would be to enable the members of an industry, if they saw fit, to band together in an agreement for the purpose referred to and for the ultimate purpose of maintaining such protective tariff rates as they deem necessary for their own welfare.

V

In considering the constitutionality of tariff legislation of the type under discussion, and the form it should take, it was necessary also to consider the general question of to what extent, and how, collateral purposes may be effected through tax laws.

The danger signals of such cases as the Child Labor Tax Case (1922), 259 U.S. 20; Hill v. Wallace (1922), 259 U.S. 44; Trusler v. Crooks (1925), 269 U.S. 475, and Linder v. United States (1925), 268 U.S. 5, were regarded.

In the last case cited, the Supreme Court, in an opinion delivered by Mr. Justice McReynolds, set aside conviction of the defendant, a physician who had been charged with dispensing opium to an addict of the drug, not for the purpose of treating "any disease other than such addiction". The court said:

"Congress cannot under pretext of executing delegated power, pass laws for the accomplishment of objects not entrusted to the Federal government and we accept as established doctrine than any provision of an Act of Congress ostensibly enacted under power granted by the Constitution not naturally and reasonably adapted to the effective exercise of such power but solely to the achievement of something wholly within power reserved to the States, is invalid and cannot be enforced. . . . Obviously, direct control of medical practice in the States is beyond the power of the Federal government. Incidental regulation of such practice by Congress through a taxing act, cannot extend to matters plainly inappropriate or unnecessary to reasonable enforcement of a revenue measure. The enactment . . . says nothing of 'addicts' and does not undertake to prescribe methods for their medical treatment. They are diseased, and proper subject for such treatment. . . ."

Hill v. Wallace, supra, involved the constitutionality of "an act taxing contracts for the sale of grain for future delivery and options for such contracts, and providing for the regulation of boards of trade and other purposes." The opinion by Mr. Chief Justice Taft, stated:

"It is impossible to escape the conviction, from a full reading of this law, that it was enacted for the purpose of regulating the conduct of the business of boards of trade. . . .

"Indeed the title of the act recites that one of its purposes is the regulation of boards of trade. . . . The manifest purpose of the tax is to compel boards of trade to comply with regulations, many of which can have no relevancy to the collection of the tax at all . . . ."

Trusler v. Crooks, supra, considered the same act, the particular question being whether Section 3, a taxing provision, was constitutional in spite of the unconstitutionality of those parts of the act directly involved in the case of Hill v. Wallace. The court held this section also unconstitutional, saying:

"Section 3 was not intended to produce revenue but to prohibit all such contracts as part of the described regulatory plan."

The well known Child Labor Tax Case (Bailey v. Drexel Furniture Company) above cited, held unconstitutional the Child Labor Law of 1919. This law attempted to impose an excise tax equivalent to ten per cent of the net profits of the business of "any mine, quarry, mill, tannery, workshop, factory, or manufacturing establishment" which should, during any year, employ child labor. It was immaterial whether one child or hundreds of children were employed (the ages at which the tax was to be effective being specified). The statute provided exemption when minors under the specified ages were employed without knowledge that the age limits had been infringed.

It had been attempted to assess a penalty of $6,312.79 against the Drexel Furniture Company because it had employed a boy under fourteen years of age to work in its factory. The court stated the fundamental question in the following words:

"Does this law impose a tax with only that incidental restraint and regulation which a tax must inevitably involve? Or does it regulate by the use of a so-called tax as a penalty?"

The court pointed out that the amount chargeable was not one proportionate in any degree to the extent or frequency of departures from the standards; and also that the charge was not imposed, unless the age limits were knowingly infringed, stating that "scienter is associated with penalties, not with taxes." It also emphasized that factories were made subject to inspection not only by the taxing officer but by the Department of Labor, the functions of which do not pertain to taxes but to the protection of the welfare of workers. It said:

"In the light of these features of the act, the court must be blind not to see that the so-called 'tax' is imposed to stop the employment of children within the age limits prescribed. Its prohibitory and regulatory effect and purpose all others can see and understand. How can we shut our minds to it? . . .

"Out of a proper respect for the acts of a coordinate branch of the Government, this court has gone far enough to sustain taxing acts as such, even though there has been ground for suspecting from the weight of the tax it was intended to destroy its subject. But, in the act before us, the presumption of validity cannot prevail, because the proof of the contrary is found on the very face of its provisions. Grant the validity of this law, and all that Congress

would need to do, hereafter, in seeking to take over to its control any one of the great number of subjects of public interest, jurisdiction of which the States have never parted with, and which are reserved to them by the Tenth Amendment, would be to enact a detailed measure of complete regulation of the subject and enforce it by a so-called tax upon departures from it. To give such magic to the word 'tax' would be to break down all constitutional limitation of the powers of Congress and completely wipe out the sovereignty of the states."

Consideration of such cases as the foregoing influences this memorandum to the extent of making the suggested declaration of policy in Part IV less explicit and detailed than it would otherwise have been and in causing the suggestion that the exemption from anti-trust laws should be in a separate act, rather than being part of the tariff act. In other words, the memorandum recognizes the desirability of leaving no possibility for contention that the proposed tariff provisions are not in fact related to revenue raising, but to other masquerading purposes.

But nothing in the foregoing cases seems sufficient to cast doubt upon the constitutionality of applying flexible tariff provisions to the purposes herein discussed. In the first place, there is a long line of cases which uphold the right of legislative bodies to frame tax measures with other objects in view in addition to that of securing revenue. Several of these, beginning at an early date, are reviewed in the Child Labor Tax Case, supra.

Among later cases sustaining legislative right to accomplish collateral purposes through tax legislation are: Nigro v. United States (1928), 276 U.S. 332; Casey v. United States (1925), 276 U.S. 420; Magnona v. Hamilton (1934), 292 U.S. 44; Fox v. Standard Oil Company (1935), 294 U.S. 100.

The Nigro and Casey Cases sustained the Harrison Anti-Narcotic Act. It may be accepted as a matter of general knowledge that the primary purpose of this Act is not to raise revenue but to restrict traffic in narcotic drugs, and thus to advance the physical and moral welfare of the American people. This appears also from two quotations. The first is from the dissenting opinion of Mr. Justice McReynolds (who it has been observed wrote the opinion of the Court holding unconstitutional previous anti-narcotic tax law provisions), and is as follows:

"I can discover no adequate ground for thinking Congress could have supposed that collection of the prescribed tax would be materially aided by requiring those who engage in selling surreptitiously to consumers to do an impossible thing - receive an order upon a blank which the purchaser could not obtain. The plain intent is to control the traffic within the States by preventing sales except to registered persons and holders of prescriptions, and this amounts to an attempted regulation of something reserved to the States. . . ."

From the majority opinion sustaining the Act which was written by Mr. Chief Justice Taft, the following is quoted as an answer to the foregoing argument of Mr. Chief Justice McReynolds and other dissenting Justices:

"Congress does not exceed its power if the object is laying a tax and the interference with lawful purchasers and users of the drug is reasonably adapted to securing the payment of the tax. Nor does it render

such qualification or interference with the original state right an invasion of it because it may incidentally discourage some in the harmful use of the thing taxed."

Magnano v. Hamilton, supra, was an action by a corporation of the State of Washington attacking a statute of that State which placed a tax of 15 cents per pound on oleomargarine. This company was the manufacturer of Nucoa, admittedly a meritorious product. Prior to the passage of the Act it had derived a large annual net profit from sales within the State, and since then it had made no intrastate sales. Its contention was that the tax was for "the sole purpose of burdening and prohibiting manufacture, importation, and sale of oleomargarine in aid of the dairy industry." To this the court answered:

"The collateral purposes of a legislature in devising a tax of a kind within the reach of its lawful purpose are matters beyond the scope of judicial inquiry."

Quoting Alaska Fish Co. v. Smith, 255 U.S. 44, the court said:

"Even if the tax should destroy the business, it would not be made invalid. . . ."

In conclusion the opinion stated:

"From the beginning of our government, the courts have sustained taxes, although imposed with the collateral intent of effecting ulterior ends which considered apart were beyond constitutional power of lawmakers to realize by legislation directly addressed to their accomplishment."

Fox v. Standard Oil Co., 294 U.S. 100 is a very interesting case decided during the present year, the opinion being by Mr. Justice Cardozo. It considered an attack upon a state statute which provided a tax on stores beginning with $2.00 assessed against a single independent store, the levy against each store rapidly increasing according to the number of stores in the chain of which it was a part. It seems to have been conceded that where there were as many individual places of business as were conducted by the Standard Oil Company, the tax reached a proportion which took the entire profit of many of the stores. The court said:

"A chain . . . is a distinctive business species with its own capacities and functions. . . . Broadly speaking its opportunities become greater with the number of component links in the chain. For that reason the state may tax the large chains more heavily than the small ones. Not only may it do this, but it may make the tax so heavy as to discourage multiplication of the units to an extent believed to be inordinate, and by the incidents of the burden develop other forms of industry. . . . A motive to build up through legislation the quality of men may be as creditable in the thought of some as a motive to magnify the quantity of trade. Courts do not choose between such values in adjudging legislative powers. . . . The tax now assailed may have its roots in an erroneous conception of the ills of the body politic, or of the efficacy of such a measure to bring about a cure. We have no thought in anything we have written to declare it expedient or even just, or for that matter to declare the contrary. We deal with power only."

While it is interesting and instructive to consider the foregoing cases, pro and con, construing tax measures with collateral purposes, those cases most important to the subject of this memorandum are the ones directly involving tariff provisions. Those already cited in Part III of this memorandum, it seems, conclusively sustain the proposition that tariff legislation may, by provisions for flexible rates, protect wage and hour standards of labor.

VI.

Any method of maintaining wage and hour standards through application of the principle of the "flexible tariff" could at most be used only as an auxiliary method of securing the end in view. There would be many industries not directly affected by the tariff. In such industries abuses as to wage and hour standards would not be vulnerable to tariff regulations and would need to be reached by some other method.

VII.

Furthermore, I shall state in conclusion the opinion already expressed in the summary (introductory paragraph 1), that the principle of securing or maintaining satisfactory standards for labor through "flexible tariff provisions" cannot be relied upon as an effective method, probably not even as an effective auxiliary method. This is because of two reasons: First, that there are better approaches, and second, there are inescapable obstacles inherent in this plan.

As to the better methods, it may not be too much to expect that ultimately the Federal Government will be vested with more adequate power to meet responsibility for social conditions through Constitutional amendment. In the meanwhile, the simple expedient of bringing a large section of industry in line through requirements of Government contract, as sought under the Walsh Bill now pending before Congress, promises better results than could be accomplished under the more pretentious plan which is the subject of this memorandum. Application of the taxing power, with taxes to be remitted in whole or in part to members of an industry maintaining acceptable wage and hour standards, after the fashion of the Guffey Coal Bill, also seems a much more practical undertaking (if it avoids constitutional pitfalls, suggested by the cases discussed in Part V of this memorandum). Likewise, the licensing plan of the O'Mahoney Bill would seem more effective (if, again, doubts as to constitutionality of such legislation can be resolved in its favor).

The inescapable obstacles to the success of any plan for effectuating satisfactory wage and labor standards through means of tariff manipulation are numerous. In addition to the one referred to in Part VI, and to general administrative difficulties such as lead to the Senate Committee action referred to in Part III of this memorandum, there would be strong protest against what would be alleged to be the indirection and subterfuge of the plan. But the foremost obstacle is that no American industry is a complete monopoly, however near the approach may be in some instances. Therefore, in every industry there would inevitably be those members who would cooperate in maintaining proper conditions of labor, and those "chiseling" members who would not. Changes of tariff rates would affect both, according to the Scripturally announced principle that "rain falleth alike upon the just and the unjust."